OFFICE OF THE UNDER SECRETARY OF DEFENSE

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ACQUISITION AND TECHNOLOGY

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DP/CPF

MEMORANDUM FOR DIRECTORS OF DEFENSE AGENCIES
DEPUTY FOR ACQUISITION AND BUSINESS MANAGEMENT, ASN(RD&A)/ABM
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE (CONTRACTING), SAF/AQC
DEPUTY ASSISTANT SECRETARY OF THE ARMY (PROCUREMENT)
DEPUTY DIRECTOR (ACQUISITION), DEFENSE LOGISTICS AGENCY

SUBJECT: Performance-Based Payments

Last year, the Department of Defense made over $3 billion in performance-based payments (PBPs). PBPs have proven to be an effective means of providing contract financing, with reduced burden to both the government and contractors. However, this experience has also indicated a need for some clarification of policies that pertain to their use.

When considering PBPs, contracting officers must remember that they are a form of contract financing, and are subject not only to FAR 32.10 requirements regarding PBPs, but also to the requirements of FAR 32.1 concerning all forms of non-commercial purchase financing. In particular, negotiated terms and conditions for PBPs should comply with FAR 32.104(a), which requires that "Government financing shall be provided only to the extent actually needed for prompt and efficient performance, considering the availability of private financing." Payment amounts should represent what the contractor could reasonably be expected to incur to achieve the payment event, rather than resemble advance payments or an inducement for the contractor to achieve performance levels that exceed contract requirements.

PBPs that exceed the contractor's actual financing needs increase the interest cost to the Treasury. To ensure an appropriate level of financing, contracting officers should consider obtaining expenditure forecasts from the contractor as part of a complete evaluation of proposed PBPs. Our goal is to prevent payment amounts in excess of a contractor's forecasted financing needs.

FAR 32.104(a) also requires the contracting officer to avoid any undue risk of monetary loss to the Government through the financing. As with progress payments based on costs, the financing provided through PBPs is secured by the vesting of title to the Government of property acquired or produced under the contract. To avoid undue risk of loss, contracting officers should negotiate PBPs that establish payment amounts not expected to exceed the projected tangible value of that property.

Considerable information regarding the use and administration of PBPs is now available at the Defense Contract Management Command (DCMC) website (www.dcmc.hq.dla.mil). Contracting professionals involved with the negotiation or administration of PBPs will find this information helpful.

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